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Conference Call of IDFC Limited

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Presentation Session

Moderator: Good evening ladies and gentlemen. I'm Shirley, moderator for this conference. Welcome to the conference call of IDFC Limited. We have with us today Mr. Rajiv Lalll, CEO of IDFC Limited and his team. At this moment, all participants are in listen-only mode. Later, we will conduct a question and answer session, at that time if you have a question, please press * and 1 on your telephone keypad. Please note this conference is recorded. I would now like to handover the conference to Mr. Bimal Giri for opening remarks.

Bimal Giri: Good evening everyone. I welcome you to this conference call organized to discuss our financial results for the first quarter of financial year 2009 announced earlier today. I have with me Rajiv Lall, Managing Director and CEO, Vikram Limaye, Executive Director, and L. K. Narayan, Executive Director and CFO of IDFC. Before we begin, I would like to state that some of the statements made in today's discussions may be forward looking in nature, and may involve risks and uncertainties. Documents relating to our financial performance were e-mailed to all of you earlier today. These documents have also been posted on our corporate website. I now invite Rajiv to provide key highlights of our performance.

Rajiv Lall: Thank you Bimal and good evening to all of you. Thanks for joining us today. Let me run you through the financial performance and corporate highlights. Then, we can go to Q&A.

If you look at the numbers for Q1FY08 relative to Q1FY09, there has been substantial improvement in our operating income, which has gone up from 299 crores in Q1FY08 to 382 crores in Q1FY09; which is a healthy increase of 28%. Net interest income expanded by 60% from 133 crores to 214 crores. This consists of two components; net interest income from infrastructure loan was higher by 71% from 104 crores to 177 crores. NII on treasury operation was also higher by 22% from 30 crores to 36 crores. On the other hand, our non-interest income declined marginally from 165 crores in Q108 to 162 crores in Q109. Our non-interest income activities come from different lines of business, of which income from our principal investments declined 19% from 78 crores to 64 crores.

I would add that the decline in our principal investments was basically because we did not monetize any of our unrealized capital gains on account of the obviously adverse market conditions. Income from asset management on the other hand increased by 29% from 13 crores to 17 crores Our AUMs have gone up on account of fund raising activities, both at what we call our project equity business as well as our private equity business and now to some extent also from the AMC business, which is the Stanchart business. Income from investment banking came down not surprisingly given the condition of the capital markets from 50 crores in Q108 to 36 crores in Q109 and this included various income streams. There was broking, investment banking, as well as other equity placement and debt capital markets fees, which is all in those numbers. Other fee income, miscellaneous fees actually doubled from 23 crores to 46 crores and this includes items such as front-end fees and some miscellaneous transaction related structuring fees, which are more adhoc in nature rather than any indication of a sustainable business.

So much for income, our operating expenses increased from 50 crores in Q108 to 78 crores in Q109. The growth in operating expenditure was driven in part by employee cost. The cost-to-income ratio on a rolling 12-month basis has trended up from 19% to 20 % as we continue to build some of the businesses that we have invested in. Pre-provisioning profits, therefore, increased by 22% from 249 crores in Q108 to 303 crores in the current quarter. Provisioning increase from 6 crores to 16 crores and this was in part, you will recall, because of the change in our provisioning policy against standard assets where we decided to raise the provisioning from 0.5% to 1% on our internally rated projects that are rated as B and C, which roughly translate to a BBB and above. Consolidated PBT improved by 18% from 242 crores in Q108 to 287 crores in Q109. There was a marginal reduction in our effective tax rate, which went down from 26.3% to 26% and accordingly, profits after tax are up 20% in Q109 - they were 217 crores compared to 181 crores in Q108. That is it for the P&L.

Let me give you some of our ROA tree analysis, which we do on a rolling 12-month basis. The overall spread actually increased from 2.1% in the 12 months ending March 31, 2008 to 2.2% for the 12 months ending June 2008, which is good. Net interest income was also stable at 2.9% of average total assets and within that NII from infrastructure contributed 2.4% percentage points and treasury contributed the balance 0.5% percentage points, which is basically the same as the prior 12 months period. Non-interest income as a share of average assets was 2.3% compared to 2.6% in 08. Contribution of principal investments declined marginally from 0.9% to 0.8%. The contribution of asset management was stable at 0.2% of average assets while the contribution of investment banking declined from 0.8% to 0.7% of average assets. Operating expenses were stable; at least as a share of average total assets at 1.1% and provisions too were stable at 0.3%. The impact from the provision for tax and minority interest was marginally lower from 1.1% to 1.0%. At the PAT level, the return on assets was somewhat lower, down from 3.1% for the 12 months ending March 31, 2008 to 2.9% for the 12 months ending June 30, 2008.

Now, let us turn to the balance sheet. We increased our balance sheet by 43% from 20,593 crores in Q108 to 29,510 crores in Q109. Our loan book expanded by 42% from 15,108 crores to 21,489 crores, again Q1 compared to Q1 last year. Gross approvals were higher by 5% from 4,286 to 4,457 crores and growth disbursements expanded by 12%, growing from 2,400 odd crores in Q108 to 2700 odd crores for Q109. Equity book increased substantially - it grew from 983 crores Q1 last year to 2,688 crores Q1 this year. Of this 2,688 crores, just about less than 200 crores were actually in the form of assets that were warehoused for our project equity fund and the very large increase in this number is in large part due to the 834 crore investment in the asset management company. This is the StanChart Asset Management Company. On the liability side, our outstanding borrowings increased 36% from 17,500 odd crores to 23,845 crores. The leverage ratio has increased from five times to about 5.2 times on a rolling 12 months basis and the ROE has declined from 15.6% to 14.3%.

A little more colour on our lending businesses, our overall exposure expanded by 48% and now stands at 36,307 crores. Of that, energy and transportation together have come down from roughly two third to about 58%. So, in Q108 exposure to these two sectors was 65.5%. It has now come down to 57.9%. Telecom exposure on the other hand increased to 18.8% from 15.7% last year.

Quickly some recent corporate developments. We are very pleased with how our fund raising efforts have gone with our project equity fund. We had our first close of $522.5 million. We are chasing a target of a billion dollars. I know that as of yesterday, we had commitments for $880 million, so we are well on track to raising close to a billion dollars on that fund, despite a very difficult fund raising environment. Likewise, the third IDFC private equity fund has raised $700 million. That's the good news. The bad news is that we are not able or were not able to book asset management fees for the third PE fund this first quarter because we are still awaiting the regulatory approval from the RBI for what is called as FVCI approval. When that comes, we will be accruing management fees on that fund as well. So, together, all our private equity business and project equity business, our total assets under management have gone up to $2.4 billion, which is very much as we had projected to you sometime ago.

Next, the acquisition of the asset management business of StanChart was completed. It has now been renamed IDFC Mutual Fund and the various schemes have also been re-branded. We have just completed the integration of the IT systems and reporting systems, etc., and that has gone without a glitch. It is still very early days and needless to say we are now focused on building that business notwithstanding the significant headwinds that the Gods of global weather have handed down to us in the form of severe dropdown in the capital market.

Lastly, again under very difficult circumstances, our investment banking business has done quite a creditable job. What has happened is actually our brokerage volumes have come down, but they have been compensated in large parts by investment banking activities and in the first quarter, we successfully raised funds for Gammon Infrastructure and KSK Energy through a QIP/ IPO route. These were significant transactions, if only because of the very difficult circumstances under which they were executed.

Looking forward to the remaining three quarters of this year, I will deal with that more through the Q&As, but I will tell you that as we had been predicting to you when we last talked at the end of the last quarter, macro wise things have not improved and that will be the under statement of this year. What this means is that we are facing significant headwinds that come from increasing macro risk, which means uncertainty with respect to the robustness of our clients that are coming on board, which has made us much more, shall we say, risk averse about booking new assets and has made us redouble our focus on managing the assets that we have. Second, rating agencies presumably stung by their international experience have taken on a much harsher stance vis-à-vis IDFC and are insisting on Tier 1 capital adequacy that is significantly higher than what we had been led to believe earlier and what it means is that we will need to raise some capital this year. Because under no circumstance can we allow, under the present macro context, to jeopardize our ratings. That is absolutely the last thing that we will allow to happen. We are at it as you may have noticed, perhaps, from the agenda for the AGM, we had allowed for a very generous leeway in terms of raising additional capital. We are not going to raise 750 million, but we will be raising some additional capital. We will get more clarity on this over the next quarter, but that is something that you can certainly expect on top of our generally cautious body language with respect to how we grow our loan book under these choppy times. Let me stop there and open the session to Q&A.

Moderator: Thank you sir.

Question and Answer Session

Moderator: Thank you sir. Ladies and gentlemen, we will now begin the question and answer session. If you have a question, please press * and 1 on your telephone keypad and wait for your turn to ask the question. If your question has been answered before your turn, and you wish to withdraw your request, you may do so by pressing # key.

Our first question comes from Mr. Amit Ganatra of Lotus India.

Amit Ganatra: Sir, just a couple of questions. One is that, under the AMC fees have you included the AMC fees from Stanchart AMC?

Vikram Limaye: Only for one month, because the acquisition closed as Rajiv mentioned on the 30th of May. So, for the month of June, it has been included in the number, but it will not obviously be in the quarter of the previous year because it did not exist on our platform the previous year.

Amit Ganatra: Right. So, all operating expenses and everything includes the Stanchart AMC for one month.

Rajiv Lall: Yes.

Amit Ganatra: Okay. And sir, now with these new RBI norms, would the minimum capital adequacy requirement for us increase to 15%?

Rajiv Lall: Yeah, but we are already capitalized more than that.

Amit Ganatra: Yeah, just trying to understand the regulatory change.

Rajiv Lall: Regulatory change is definitely on the cards, but more than that it is the stance of the rating agencies.

Amit Ganatra: Okay. So, you mean to say that even though we are adequately capitalized - we are having Tier 1 of around 17% right?

Rajiv Lall: Correct.

Amit Ganatra: And do they still want it to be higher or is it that since we have growth plans, that is why we might be required to raise capital?

Rajiv Lall: It is a combination of both. I think that they would in an ideal situation like to see a higher amount of Tier 1 capital than 17% and that concern of theirs is reinforced given whatever growth is taking place in our business.

Amit Ganatra: Sir, do we have any internal rating system for our loan book?

Rajiv Lall: Very much so. We have a very comprehensive internal rating system.

Amit Ganatra: Do we provide some kind of classification in terms of what kind of loan book do we have in terms of different ratings?

Rajiv Lall: We do not do that to our investor community because that is the sharing a degree of information that competitors will never dream of doing and therefore, not because we want to withhold any information from you, but we certainly want to withhold information from our competitors.

Amit Ganatra: Okay.

Rajiv Lall: That is why we do not put it up on our website.

Amit Ganatra: Sir, last two questions, one is that the duration of assets and liabilities are shown as 1.68 years. Sir, do we have such a short duration on the loan portfolio?

Vikram Limaye: The duration is about 1.7 on the asset and the liabilities side.

Rajiv Lall: It is so low and it is low because of resets, not due to the maturity profile

Amit Ganatra: Okay, okay. This is because of resets.

Rajiv Lall: That is the feature of the Indian market, which makes the duration; even for infrastructure assets quite low.

Amit Ganatra: Okay, okay got your point. And last thing is that when you calculate your NII - what things do you include in that?

Rajiv Lall: I will tell you it is different from other banks, okay? Our NII line is split into two parts, there is NII infrastructure and there is NII Treasury.

Amit Ganatra: Right.

Rajiv Lall: Okay. The treasury is really primarily a cashbook.

Amit Ganatra: Right.

Rajiv Lall: There is a trading book that is part of it. To the extent that there is a trading book, which is even smaller, which is a fraction therefore of not very large treasury book. There are some capital gains or losses implicit in the NII Treasury. But NII Infrastructure is just pure lending.

Vikram Limaye: And it is all pure spread income, which does not include any fee income.

Amit Ganatra: Okay. That is why I was facing this difference in the annual reports stated NII in the NII, which was stated in the presentation. I mean, I was trying to calculate NII through your annual report and there was some profit on sale of investment. I think, some element of that is included in our under NII.

Vikram Limaye: Is that right?

Rajiv Lall: Shouldn't be.

Bimal Giri: What we present to you is based on daily average assets, which will not be available in the annual report.

Amit Ganatra: No, I am not trying to calculate in terms of percentage.

Vikram Limaye: Yes, what you are saying is correct. The profit on sale of investments that we make gets clubbed under infrastructure. Okay, because in the annual report if you look at the segregation, it does not differentiate infra and others, so it will get captured in infra. So, you are right. If you try and get it from the annual report, I think, you won't get that right.

Rajiv Lall: So, focus on our quarterly disclosures then. That is the better way to understand the business.

Amit Ganatra: Okay. Thank you.

Moderator: Our next question comes from Mr. Rajesh Kothari of Voyager Investments.

Rajesh Kothari: Sir just, a few questions from my side. First, what kind of loan book growth you are expecting for the full year, number one? Number two, if I look at your gross approval and gross disbursements, they are basically much lower growth compared to our loan book growth, so can you just tell us some of this and the macro environment is in terms of the next one and half to two years, do you see any impact of slowdown on our, you know, future project pipeline and what is your opinion on that?

Rajiv Lall: The macro environment is not very good and I think that I will use this question to make a broader point with respect to how it is that we are positioning ourselves for the remainder of this financial year. See, what the numbers show for the first quarter, in terms of balance sheet growth and loan book growth and all that is actually reflecting the momentum of activity that has taken place over the last 12 months.

Rajesh Kothari: Absolutely.

Rajiv Lall: Okay. So, what is absolutely clear, okay, is that going forward that activity is going to slowdown.

Rajesh Kothari: Absolutely.

Rajiv Lall: And it is going to slowdown for two reasons. It is going to slowdown partly because, you know, there is a general macro slowdown, but, you know, what is interesting that is, even in this macro slowdown there are actually a lot of opportunities to lend. That said, we are consciously becoming more cautious and we are not going to grow our book nearly as aggressively as we have in the past. So, attitudinally, I think that you need to note that as far as IDFC is concerned, we want to ensure that we remain much more disciplined now about increasing our asset yields and increasing our spreads than growing the loan book. So that's an internal sort of message that has gone down the line within the organization. We are not focussed on loan growth this year; we are focussed on yield and spread. Now, where actually the loan book ends up is therefore difficult to say. We will have a better sense of that over the next quarter, but you can be sure that there will be significantly lower growth than there was last year, which is not to say that NII could be very significantly lower and that depends on our ability to manage our yields and our spreads. But attitudinally, that is an important change in footing about how we are trying to negotiate these choppy times. Second, the attitudinal change partly in view of the macro environment and partly in view of the stance that rating agencies are taking is that we are in capital conservation mode. So, we deploy capital in those businesses that overtime will generate higher ROEs rather than just again growth for the sake of volume and businesses that are throwing up lower ROEs. Third attitudinal change is that we have become and hopefully you will see the results of that much more focussed on cost control across the board. So, when you put all those three together, in a difficult environment our approach is focussed on getting paid for the risk we take, focus much more on profitability than volumes and be disciplined and intelligent about continuing to invest in those businesses that we think overtime will generate superior returns.

Moderator: Our next question comes from Mr. Mahesh of Edelweiss Securities.

Mahesh: Congratulations on a god set of numbers. I just have a few questions. One is to understand the borrowing mix; you currently have close to about $500 million in USD. How much of it is actually hedged and how do you actually report any changes of the rupee fluctuation?

L K Narayananl: Yeah. Actually, we have only 450 million dollars of foreign currency and out of that almost $330 million is on lent in dollar terms, so really there is no exchange vulnerability that we carry on these. The balance is swapped on a back-to-back basis and that is what we have.

Mahesh: Okay. So, there will be no market risk on this particular book?

Rajiv Lall: No.

Mahesh: Okay. You changed your borrowing mix little bit more towards foreign borrowings in the last two quarters, any specific reason for?

Bimal Giri: No, actually we have not done that. The balance sheet if you see, essentially is rupee funded, both assets and liability, but the foreign currency component comprises just about 8% of the total resources.

Mahesh: Okay. In terms of the investment book, today you have close to about one third of your networth in equity and equity-related instruments, how comfortable are you continuing to invest in this book?

Rajiv Lall: No. One third includes the subsidiary investment, right?

Bimal Giri: Yes.

Rajiv Lall: So, about 1,200 crores roughly is investment in subsidiaries. These are business we have, you know, we believe that overtime will generate value for us. So, we will continue to build these businesses and these are the investment banking business and the asset management businesses. Aside from that we have made our contributions to our funds, which will continue to be drawn down as various funds get deployed and then the third element of our investment is some principal investments that we have taken directly on to our balance sheet. So, really your question, I think, pertains to the third bucket and on that we believe that we still have unrealized gains of how much?

Bimal Giri: About 250

Rajiv Lall: 250 crores in this horrible market. We believe that there are opportunities to invest that could be quite compelling, we don't necessarily want to rush into anything, but our belief is that, you know, 24 months ahead we look back to this period and say I am glad we did that investment or aren't we foolish that we didn't make that investment.

Mahesh: Okay. Just to understand still how much of the networth would you actually be comfortable investing in, probably, the listed and unlisted space?

Rajiv Lall: Let me answer the question somewhat differently. I would say that we have a reasonably well-defined exercise for the allocation of economic capital to various businesses and we are very conscious of the prudential risk to our balance sheet and therefore, while today, if you look at the share of total assets that is deployed in equity is under 6%. It is fair to say that overtime that share is likely to increase some. It will not increase very dramatically anytime soon. It will increase though and that is in line with our conviction and belief that over the next six to eight months, 12 months, there will be compelling investment opportunities in our space that we will be foolish not to invest.

Mahesh: Okay. In terms, just one question on the mark to market, how do you actually provision these? Do you actually net your total gains and then see if there is any change or on the net loss over the course of the quarter, only on that would you make any provisions? Since there was no provisions for this during the course of this quarter.

Vikram Limaye: Yeah. So, the way you have to think about our equity book is, as Rajiv outlined, there are some liquid listed investments and several unlisted investments. The liquid investments are also long term investment. This is not a trading book. These are not the things that we buy today and sell next month. These are all long-term investments that we have made. Unless, we believe that there is a permanent diminution in the value of these investments, we do not make provisions against these investments. Last year, we did make provisions against a couple of investments that existed in our liquid book to bring them down in line with where the market prices were because we believed that it was unlikely that we would see any kind of significant appreciation beyond those prices over the foreseeable future. We do not see any such investments currently in the book that would warrant incremental provision.

Mahesh: Okay. Just last two questions. One on the core infrastructure side, if you look at FY08, the operating cost in fact had jumped from, roughly about 40 basis points to your average assets, which you have been maintaining over the last three years to about 50 basis points and right across there has been increases in almost every segment, any specific reason for this?

Rajiv Lall: Well, operating expenses you are talking about?

Mahesh: Yeah.

Rajiv Lall: That's because of the full integration of SSKI.

Mahesh: No, in the stand alone book.

Rajiv Lall: In the standard loan book, it is primarily HR expenses.

Mahesh: How do you see this going this year?

Rajiv Lall: HR expenses, my colleagues will hate me for saying this, but I think bonuses are going to be slashed this year.

Mahesh: Okay. And just one question, what has been the incremental borrowing cost, which you have been witnessing this year, in this quarter?

Rajiv Lall: I don't think we give that information, but we will give you spread information. So, we are giving you, what are we giving them now?

Vikram Limaye: Spread.

Rajiv Lall: We are giving you the spread. It has gone up.

Mahesh: Okay fine. Thanks.

Vikram Limaye: Oh! You're talking about cost of funds

Rajiv Lall: Yeah, we have that cost of funds don't we?

Vikram Limaye: But you know that we are an AAA borrower, right? So, if you are an AAA borrower, you know what the AAA spreads are over the government in the market.

Rajiv Lall: That's it.

Mahesh: Okay fine. Thanks.

Rajiv Lall: All right.

Moderator: Our next question comes from Mr. Amit Goel of UTI Mutual Funds.

Amit Goel: Sir, just a question on the interest income from treasury operations, on a sequential basis it is up by some 70% and if I look at the, I am trying to understand whether this is a relative, is it corollary to your investment book where the treasury has been listed at Rs. 4,990 crore, which is down by 5% on a sequential basis, I am just trying to get some sense here, are they related this year then how is this jump?

L K Narayanan: No, the Rs. 4,990 crore like Rajiv said in his opening comments, there are two books, one is the liquidity book and the other is the principal investment from treasury that we are doing. So, liquidity is basically just to keep a certain volume of cash to meet obligation on the asset as well as the liability side. As far as the return is concerned, therefore it comes essentially from the principal investment book and there were some investments that we had made in the previous year, which we have unlocked in this quarter.

Amit Goel: Okay, thank you.

Moderator: Our next question comes from Mr. Ashish Sharma of Enam AMC

Ashish Sharma: Just wanted to corroborate on a point that you had mentioned last time also that going forward the spreads would be under pressure. I mean, in the last quarter, we have seen a tightened environment for NBFCs. I mean, assuming within the two scenarios, no further tightening by RBI and further tightening by RBI. Would it be impacting the spreads on infrastructure prices?

Rajiv Lall: Well, I think for the immediate future, our spreads would be under some pressure, but as I explained in response to another question, we are much more focussed now on maintaining if not expanding our spreads versus growing the volume of our lending business. And what we find at least anecdotally is that at least in this cycle, the degree of uncertainty is significantly greater than last time around we were faced with a similar situation. And what that means is that there is some degree of risk version across the financial system for our type of business, for our type of assets, right. And therefore, our pricing power, which is still to be tested, but our pricing power is actually greater than it might have otherwise been expected to be and so we think that we have a, you know, fairly good shot at maintaining buoyant spreads as the pace of our lending business actually slows down.

Ashish Sharma: I was just trying to get a sense because you provide spreads on a 12 month basis and for the last quarter would they have gone down considerably to the 1.9% and 1.8% of this?

Rajiv Lall: No, no, they haven't gone down that much, no. If they have gone down, they will go down marginally on an incremental basis.

Ashish Sharma: Okay sir. And second question is on this capital raising exercise. Would it presumably tend to be equity raising or would it be your Tier 2 capital sir, you had mentioned that earlier.

Rajiv Lall: See, we will do whatever we can get away with in terms of the minimum dilution possible to existing shareholders without upsetting the apple cart vis-à-vis the rating agencies.

Ashish Sharma: Okay.

Rajiv Lall: So, what combination of Tier 1, Tier 2, this is all subject to more discussion, etc, etc., with rating agencies. We will have a better idea of that, maybe, in a quarter.

Ashish Sharma: Definitely, it would be a mix of both equity dilution and your debt equities…

Rajiv Lall: I cannot say at this time. We would like it to be a mix. It may not be a mix. It may just be Tier 1. We will see.

Ashish Sharma: Okay. Fine sir. And I just wanted to get your treasury assets figure as on June 30, 2008

L K Narayanan: You want just the volume number or what exactly you want please.

Rajiv Lall: Outstanding treasury asset.

Ashish Sharma: How much funds are there in the treasury asset, like you have mentioned in the March 08 figure, it was close to….

L K Narayanan: Rs. 4,990 crore

Ashish Sharma: How much sir.

L K Narayanan: 4990 crores at the aggregate treasury book.

Ashish Sharma: That is primarily debt only?

L K Narayanan: There is no equity position that is run in treasury, everything is in fixed income between the two books like I described, between the cash book and the principal investment book, and everything is in fixed income.

Ashish Sharma: Okay sir. And I just wanted to get a sense on the principal investment size, Rs. 64 crore, does it include capital gains plus carried interest and what is the mix, if you can provide me the figure for that?

Rajiv Lall: Rs. 64 crore.

Vikram Limaye: We don't provide the mix between carry and all that, but it does include gains that we booked on equity investments that we have made that we have monetized. And that could be a mix of unlisted investments and listed investment.

Ashish Sharma: Okay. Another classification on this investment banking income sir. The last quarter income is, I think, the 66% share for IDFC, so income has gone down considerably for some IDFC SSKI, because it is representing 79.8% of your share this quarter and last time it was 66%.

Vikram Limaye: The way it is happening in the numbers is that it is in the line item in the revenue line that you see 100% is accounted for, it is taken out in your minority interest line at the bottom, okay?

Rajiv Lall: So, it will be consolidated.

Vikram Limaye: Yeah. So, you are comparing like with like.

Ashish Sharma: Because, earlier you mentioned that it is line by line basis so we were doing it as proportionate share of revenues coming in IDFC SSKI.

Rajiv Lall: That is when it was 33%, but the moment we crossed 50%, it became 100% consolidation and then we take out the minority interest at the bottom of the page.

Ashish Sharma: Okay. I just wanted to know on the pipelines for this investment banking side going forward. We know the macro operating environment is not as conducive as last year, but still I mean we have something in the pipeline on the investment banking side?

Rajiv Lall: We always have things in the pipeline, but whether that pipeline translates into actual deal can't say. I mean, you know, you know the mindset of our promoters in this country. They still think that this is…a lot of them, I don't want to make light of it, but lot of them are hoping that this is a temporary phenomenon that somehow markets will be back magically next quarter and we continue to pitch for mandates, etc, etc. but I don't think to be perfectly blunt about it that Q2 is going to look all that exciting for our investment banking.

Ashish Sharma: Okay sir, and sir just last question on the employee base, I mean, what is the employee base including SSKI and AMC plus IDFC employee as on April?

Vikram Limaye: How many employees?

Ashish Sharma: Yes sir.

Vikram Limaye: Around 450.

Ashish Sharma: 450, thank you sir, thanks a lot.

Moderator: Our next question comes from Mr. Prashant Poddar of ICICI Prudential.

Prashant Poddar: Congratulations sir for a great set of numbers and a great quarter. My question is more on your customers sir, would you have observed that the cost of project for a customer from the time of your approving the loan to the time now you are disbursing it, has it really increased?

Rajiv Lall: I think undoubtedly yes, cost of construction material, cost of, you know, steel, all of that is significantly higher and therefore project costs have gone up, but you know we have been trying to get to the bottom of this and get a better sense of how promoters are reacting to all of this and I guess the answer is to do with different sectors and depending upon what sector the project in the answer might be quite different. For example in power, if the promoter has a deal on an opportunity to develop a power plant that has got captive coal as a fuel and is able to deploy some part of the eventual megawattage into merchant sales, the cost escalation maybe brings his IRR down from the high 20s to the low 20s if that, right? And as far as he is concerned, he is still gung-ho about it. So, a lot of them are continuing to operate on that basis. I suspect that in the case of certain type of road projects, the IRRs might be more sensitive to the escalation in construction cost. So, it varies depending upon which sector it is.

Prashant Poddar: Would that be one of the reasons why in your business mix your road infrastructure is coming down?

Rajiv Lall: Yeah that is one of the reasons.

Prashant Poddar: Okay and the second thing is again just expanding that one a little, I mean, what would be the percentage increase typically for the industry part of projects, sir, not the infrastructure, not the power projects or road projects for the industry, say steel or telecom etc., what could be that increase as a percentage roughly?

Rajiv Lall: I could not tell you of the top of my hand, Vikram and LK have some view on that and what is the cost escalation on account of input cost increase?

L K Narayanan: EPC contract typically forms about 70% to 75% of the project cost. So, if you are talking about road project then automatically you know that would be very significant. 10% to 20% of cost, but just one comment I have is, you know, if you look at it all of our projects, there is a very small component only which is projects under implementation. So, the vulnerability is much less, number one issue. Number two is that some of the projects have actually had hard EPC price negotiated with various constructions.

Rajiv Lall: That's true, yeah

L K Narayanan: Sometimes some of the risk is mitigated.

Rajiv Lall: Also to add to LK's point, you know, our product mix has also changed right in the last 12 months, so we have been doing more corporate loans at the margin, not as many project loans. So, there again that does not sort of impact our book right away.

Prashant Poddar: So, is there any of the say road projects or any infrastructure project in your portfolio, which is generating lesser IRR than it should typically do to just scrape the bottom?

Rajiv Lall: No, I mean, I think that there are, I mean, if the question is are IRRs for projects lower than initially projected, the answer is probably yes - for a number of them, but if the question is have the project got to a point where what is called DSCR, the ability to service debt from cash flows is impaired, the answer is no. We don't see it at this point. That said, given all the information that is flowing in about macros, we are concerned about all of this and therefore as I sort of explained earlier, this is not the time to heroically grow our loan book. These are times to slow down and be very cautious, which is what we want to do.

Prashant Poddar: Yeah, and sir one last question is on again on the same thing, I mean, intuitively it looks like cement or steel, most of our industry is operating at very healthy capacity utilization, so intuitively it looks like that the projects that they have announced should not typically be stopped, just because your costs have gone up or so, I mean, it looks like you might be not earning certain EBITDA on those projects if you delay, intuitively I mean, so what is your sense on that?

Rajiv Lall: I think, we would agree with that. We would agree with that.

Prashant Poddar: Okay sir, thank you very much.

Moderator: Our next question comes from Mr. Jai Prakash of ULJK Securities.

Jayaprakash: Sir, I just wanted to know some details about the 20 megawatt project in the farm in Rajasthan - that is mentioned in the notes to accounts?

Rajiv Lall: Yeah, this is a wind farm that we have invested in.

Jayaprakash: Okay. And sir is there, in this quarter, you have mentioned the investment banking business, so it does include the full IDFC SSKI business, I mean income?

Rajiv Lall: Yes.

Jayaprakash: Okay sir, thank you.

Moderator: Our next question comes from Mr. Seshadri Sen of Macquarie Capital.

Seshadri Sen: Hello, good evening everyone, I just had a couple of questions, one is at the last conference call you said that once the complete acquisition of Standard Chartered was complete, you would give us some more color on the strategy, in what timeframe do you hope to earn an economic return on that rather large investment of 20% of your net worth? Secondly, in terms of your funding cost, I know you have addressed that a little, but are you planning to deemphasize bonds and debentures as a source of funds. I see that if you look at the quarterly movement in your sources of funds, you have already done a little bit of that, do you plan to further deemphasize that and look for other source of finance like bank loans which would probably be cheaper, if they are cheaper?

L K Narayanan: I will take the second part first. See between bank loans and bonds, we use market-based opportunities to our advantage. There are times when the bond route is the only available route, at other times there are bilateral loans that we sign up with various banks, so we have to always balance, so it is both from a cost optimization as well as the market condition optimization situation. Our preference is for neither, in the sense that, we choose equally between the two, but historically we have been more dependent on bank loans.

Rajiv Lall: The first question about the AMC, I think we will deliver economic return on this around the same timeframe that Macquarie improves its share price. Not to be facetitious about it. Look, we have been very upfront about it. What I maintain is that if I were still a private equity investor, I would never have paid the price we did for the AMC, but as a strategic investment, we still believe it makes good sense. We are, I mean, it is only been one month that they have really come on board, so we are actually in a huddle now looking at their plans and roll out for new products over the next 12 to 18 months and we will have, you know, more to say about that strategy probably by next quarter. That said, you know, I will be frank with you, I certainly did not see the severity of the decline in capital markets, I mean, we have all expected a correction, but the severity of the decline and just the risk aversion that has gripped the world has come as somewhat of a surprise certainly to me. So, it will be harder than we had anticipated to deliver value on as timely a basis as we had hoped for, but we have some very interesting plans for the AMC, in terms of new product development and we would be happy to share those with you in a quarter.

Seshadri Sen: Will the core business gain in terms of synergies from the AMC business, so would you be just looking at the AMC business which is not the way to look at it?

Rajiv Lall: It will, it will. We will start with working on the synergies on the core business because there are certain product innovations that we would like to introduce that are directly germane to the IDFC franchise. Some of it also depends on regulatory changes, but that is for a medium term story. And in the longer term story, just see, asset management space more generally, so that's going quite far down in time.

Seshadri Sen: Thank you very much.

Moderator: Our next question comes from Mr. Vijay Sarathi of BNP Paribas.

Vijay Sarathi: All my questions have been answered thanks.

Moderator: Our next question comes from Mr. Suresh Krishnamurthy of Crisil.

Suresh Krishnamurthy: Good evening sir. This is Suresh from Irevna, which is a division of Crisil. One question is on the rating agencies, you had previously indicated that for getting an AAA rating, a leverage of about 7 is what the rating agencies were looking at, what would be the number now?

Rajiv Lall: You should know the answer to that.

Suresh Krishnamurthy: No sir. I am part of the equity outsourcing business; I am not part of Crisil rating agencies.

Rajiv Lall: Just check with your colleague, they will tell you.

Suresh Krishnamurthy: And is the leverage linked to the strategic proportion of equities in the balance sheet?

Rajiv Lall: Not specifically, the answer of that is no. I think the amount of leverage that your colleague would be comfortable with is to do more with the macro, you know, tone. Macro / regulatory tone globally with respect to NBFCs, I think that's where it is coming from

Suresh Krishnamurthy: And implications of this for your longer term plan to resemble something like Macquarie or Babcock & Brown?

Rajiv Lall: Now, I am no longer claiming that we want to resemble Macquarie. Now again, I don't want to be facetitious. We have a longer term plan to become a Macquarie-like entity in the sense that what we want to do is the combination of balance sheet business and the asset management business. That plan still remains very much on track. I think that if anything, you know, be the change depending upon, you know, how deep and permanent the change in the mindset of rating agencies is would - actually says to us that it is that much more important for us to reposition ourselves and focus more on the ancillary businesses to a lending business than just on the capital consuming lending business. Because, if anything, the balance towards the less capital consuming businesses getting more of those earlier becomes more important for us as this change in mindset occurs within the rating agencies.

Suresh Krishnamurthy: Secondly, is your attitudinal change with respect to loan growth sectoral, I mean, are you conservative about lending to, specifically the energy sector?

Rajiv Lall: It cuts across all sectors.

Suresh Krishnamurthy: Okay. Are you seeing some slowdown on the energy sector? I mean, it is very critical for the overall macro picture investment so on and so forth?

Rajiv Lall: No, you know, there are lots of people looking for money. I am not sure we want to lend it to them.

Suresh Krishnamurthy: And plans for the public market investment advisory business sir?

Rajiv Lall: Sorry

Suresh Krishnamurthy: Public market investment advisory businesses, where you have listed some $1.4 billion of asset under management, what are your plans for that?

Rajiv Lall: You are talking about the mutual fund business?

Suresh Krishnamurthy: No sir, IDFC investment advisor?

Vikram Limaye: $1.4 billion you are talking about should be AMC AUM.

Suresh Krishnamurthy: No sir, it is listed in the last page of your presentation. IDFC investment advisor is 143 crores.

Vikram Limaye: Oh! I see 143 crores. Yeah, that is all now part of the overall public market platform within the AMC framework, so we will obviously, there are various aspects to this, there are offshore aspects, domestic aspects, etc., in terms of how we grow the platform. So, 143 crores that you are referring to is specifically an offshore fund that we are advising on, that we will certainly grow in addition to other offshore products that we launch. So that will continue as part of the platform or it will all be in the context of an overall public market platform, which would include mutual fund business as well as the investment advisory business.

Suresh Krishnamurthy: Any target for the year, AUM targets?

Vikram Limaye: No, at this point in time, I don't think it is useful to have target given the environment because

Rajiv Lall: But we will, I mean, we do have. We are in the process of formulating business plans since we have only been on board one month or less than a month. So, we will have certain milestones that we would like to meet, which we will, as we meet them, we will share them with you.

Suresh Krishnamurthy: Okay sir. Thank you.

Moderator: Our next question comes from Ms. Tabassum Inamdar of Kotak Securities.

Tabassum Inamdar: Just two questions. First of all in terms of a capital raising, basically, you are talking about leverage of five times, does that mean we should be expecting low ROEs on a more sustainable basis or this is more temporary you feel and you could be allowed to increase the leverage longer term?

Rajiv Lall: You should tell me.

Tabassum Inamdar: No, because I thought your capital adequacy is very high, so we are quite surprised with, you know, credit rating agencies demand to increase that. Because clearly your NPLs are low, your Tier 1 was 17%; your total capital adequacy is 20%.

Rajiv Lall: That was a bit difficult to answer that question. I think time will tell as I said. You know, if the macro situation were different and the rating agencies came with the body language that they did, we would be much more combative vis-à-vis them, but the reality is that, you know, these are uncertain times and as I said general body language that seems sensible at this time is to be cautious rather than heroic and therefore first and foremost we want to do everything to make sure that our rating is not jeopardized. So, we have to engage with them and then as things improve, because as deep as the global financial crisis and oil prices hike sounds depressing, this will pass and as and when the clouds starts clearing, it is difficult to say how the rating agencies will react. I will say one thing though, and this is more in the nature of philosophical rumination than anything else and since you follow this page, not over this call, but at some other time will be useful to have your views on it as well. It is that globally, right, financial services generally will have to see de-leveraging and I suspect that one way or another that wave will infect India as well and I think that the sustainable long-term ROEs for a lot of financial services businesses will have to be thought through again and I think that's just a reflection of how the world has changed in six months. There is nothing that we can do about it.

Tabassum Inamdar: Just one more, micro question. You mentioned something about your treasury book being on the fixed income side being quite large, I just wanted to check what is the kind of duration and have you taken any mark-to-market hits or have you seen any pressure on that book?

L K Narayanan: The overall duration of liabilities is as close to asset duration. So, I am just giving you a sense of the overall duration, we are matched with the asset duration.

Tabassum Inamdar: No, I am asking the treasury book because if you see the yields on the shorter end have moved up quite significantly and some of the banks are taking big hits because of that

L K Narayanan: So, see, like we said earlier, there is a cash book , which is of a very short duration and there is a principal investment book, which is of medium duration, but as far as our MTM is concerned on the treasury, there has been a mark to market hit because we run a cashbook that we have taken.

Rajiv Lall: So, that's sure, that is a small number, that's 4 or 5 crores.

Tabassum Inamdar: Okay.

L K Narayanan: Because the income has moved very dramatically given the jump in inflation number, so.

Tabassum Inamdar: Yeah, okay. Thank you.

Moderator: Our next question comes from Mr. Jatinder Agarwal of ABN-Amro.

Jatinder Agarwal: Good evening sir. Just one question, in terms of your private equity and equity assets that you manage, between Jan to date, how have promoter expectations come down in terms of valuations that they would look to give you stakes for?

Rajiv Lall: It is fair to say that promoter expectations are still relatively high. I think that it will take little more time for reality to take hold and for valuations to come down some. So, for, it is not that we are not seeing investment opportunities, it depends… we are in a state of flux right now and so the market is populated by both kinds of promoters. There are some promoters who are pragmatic and are saying okay look, I have to build the business if I don't get the valuation, I thought I could six months ago it doesn't matter, let me just go ahead. Then, there are others that just want to hold out for what they thought they could get six months ago. So, we are in that very awkward stage of where, you know, our full trend hasn't take hold, but my guess would be that over the next quarter or two, valuation expectations will come down.

Jatinder Agarwal: Okay sir. And sir, on your principal investments, which is 64 crores in terms of gains that you have booked in this quarter, could we get some flavor on that, in terms of, you know, how much of it is coming from your venture capital funds?

L K Narayanan: As I mentioned earlier, there was a similar question that was asked. We don't give a breakdown of that now. Because it's a mix of listed and unlisted investments that we monetize and also carry that we might get from our funds.

Jatinder Aggarwal: Okay sir. Thank you.

Moderator: Our next question comes from Mr. Subramaniam of SBI Capital Securities.

Subramaniam: Good evening sir. What were your gross NPL and net NPL numbers for the quarter?

Rajiv Lall: No change from the previous.

Subramaniam: Okay and one more question, which of the sectors you think are more sensitive to interest rate changes given the higher interest rates and given the current level debt equity on the balance sheet?

Vikram Limaye: It really depends on the nature of the project than how it is structured. If you look at the power sector than to the extent that these are PPAs with electricity board, etc., and you get a 14% return on equity, the rest is all pass through, so from that perspective less sensitive. But if you have a merchant power plant obviously more sensitive and in the road sector obviously is again more sensitive. Because the WPI increase in tolls, I don't think would necessarily take care of all the increases and cost that our project might encounter in terms of the set off against revenues. So, it depends on how the project is structured and what kind of cost escalation is built in and the nature of the project in terms of how you get your return. But broadly, I think, in general, you know, when people are bidding for projects, they will obviously be a lot more sensitive to the fact that we are in a rising rate environment and therefore they will have to factor that in when they bid for projects in order to maintain their equity returns.

Subramaniam: Okay. Thanks a lot sir.

Moderator: Our next question comes from Mr. Hiren of Goldman Sachs.

Hiren: In one of the earlier calls, you had mentioned that out of the total capital, you would allocate about one fourth to the principal investments and remaining three fourth to the lending activities, I mean, has it changed or?

Rajiv Lall: No, I mean, broadly, see one fourth principal also includes investments in subsidiaries.

Hiren: Okay. So, because, earlier you mentioned that, you know, maybe in the current environment you would be more capital conscious and that's why you maybe allocating more to the businesses, which may generate higher ROE.

Rajiv Lall: Yes, yes.

Hiren: And does it have any implications on the way rating agencies perceive you?

Rajiv Lall: It is one element of the whole thing. I think the rating agency conversation, as LK was suggesting, you know, at least three dimensions, one is the most important and overwhelmingly the dominant part of the view comes from the macro and just, you know, global regulatory change in stance vis-à-vis NBFCs. Second is their particular concerns with respect to the impact of macro on the infrastructure sector in India, which you know, we can agree to disagree with them, but they have a view and they hold on to that. And the third aspect is to do with our own structure actually, not so much the structure of balance sheet and the structure of our assets composition, but actually to the structure of our ownership. You know, they are taking the view that since we are not sovereign backed that basically our capital adequacy needs to be higher. I do not know what to argue against that, but that's where their view is coming from.

Hiren: One more related question on the Tier 1 side, can you elaborate what gets knocked down from your net worth for the computation of Tier 1 capital?

Vikram Limaye: The basic formula is anything that is in excess of 10% of net worth that is invested in subsidiaries, not portfolio investments that you make, not investments as contributions to our funds, business, or any of those type of investments, but any strategic investments in subsidiaries in excess of 10% of net worth will get deducted in computing capital adequacy.

Hiren: But the total investment in subsidiaries will have to higher than 10% of the net worth?

Vikram Limaye: The amount invested in subsidiaries, that is, in excess of 10% of net worth will get deducted from your total capital in computing capital adequacy.

Hiren: Okay. Thanks. One more question on the loan against share book, which is around 10% of the total loan, can you share some, I mean, what kind of pricing, collateral view insists and what kind of?

Rajiv Lall: We do not want to go into too much detail on that, but I will say two things, one is that collateral has a lot of cushion in it. We are very conscious of liquidity and volatility when we ask for loan-to-value kind of calculations in determining the amount of security that we require and second, this is really a very lucrative product and our own view internally is that lucre notwithstanding we have to be very disciplined about how much we do in this business. So, we have an internal threshold and we will not exceed our exposure to this business beyond that.

Vikram Limaye: Also you should know that, as Rajiv said…

Rajiv Lall: The portfolio has actually performed very well

Management: Yeah, so we have been very disciplined about this book. So this is not lending to small marginal promoters, companies, etc. These are all quality promoters with underlying security that as Rajiv said has the liquidity profile and the quality profile that we believe is important given market condition etc., and there is cushion and there are top-up provisions, especially in this environment as you see stock prices decline that we are certainly comfortable that there is enough cushion in this book given where the markets are today as well.

Hiren: Is it normally the infrastructure-related companies only or?

Rajiv Lall: Only infrastructure-related companies.

Management: This is basically to help promoters invest equity in their projects and future projects, etc.

Rajiv Lall: The companies and promoters we know well.

Hiren: Would there be any other security as well in this book, other than the shares?

Vikram Limaye: It's primarily shares.

Hiren: Primarily shares. Okay. One last question on one of your associate companies, which is Athena Developers anything which you can share on that?

Rajiv Lall: Athena Developers is in the development stage. I think that it is difficult to, it is an unlisted entity, it has access to a number of power development opportunities that the company is executing on. You will see the effect in the next, this is a long gestation thing and it will take two, three, four quarters before we can share more information on this. So, there will be any information worth sharing with you, but you know it continues to feel interesting and good, overtime we will create something of value, but you know it is a development activity and it takes time.

Hiren: Okay thanks a lot.

Rajiv Lall: We have time enough for one more question.

Moderator: Our next question comes from Mr. Manish of Citigroup.

Manish: Hi, Rajiv, Vikram, just one question, I mean, in the past you have said that the way to look at the growth in your outstanding disbursement is basically also to look at the exposures level. If I look at that, I mean, your current exposure is like 50% among disbursement level. Is this, I mean, kind of a projected trajectory of the loan for the next 12 to 18 months?

Rajiv Lall: There are also repayments that happen along the way. So, you have to net off the repayment is difficult for you to build a model that can do it in that particular way. I was trying to indicate earlier the numbers that you see in our loan book and balance sheet for the first quarter this year are reflective of the momentum that has built up over the last 12 months. Attitudinally, we are not inclined to continue with that phase.

Manish: Probably, one more thing on this is, I mean, you have a lot of undisbursed commitment for the sake of your gross approvals and gross disbursements, what timeframe would they generally be disbursing, would be over next 12 to 18 months or would be?

Vikram Limaye: It will longer than that. Probably, be more like 24 months.

Manish: Okay, and couple of housekeeping questions, one your fee side, the loan and related fee side has actually increased substantially, is there any one-offs on this or is this level sustainable?

Rajiv Lall: Sorry, what fees it is?

Manish: The loan related and other fee components?

Vikram Limaye: As Rajiv said, that also includes some fees relating to structuring fees on specific deals, which, as you know, it cannot be assumed to recurring business, because they are deal specific. There is a component in that that is steady, which relates to the fees that we earn on the lending business and that will obviously grow in line with what we do in new disbursements, etc., but it does include some element of deal-specific fees that may not recur.

Manish: You quantify this proportion as a customer basis of the stable versus one off?

Bimal Giri: I think as a percentage of growth disbursement, there that will be 0.5% coming as front end fees that can be the stabilizing percentage.

Manish: And secondly, I mean on this, your operating expenses side, even from the last quarter you have reduced substantially in terms of the operating expenses despite the Standard Chartered AMC coming in, any particular areas that have actually reduced in terms of expenses or is it all related to HR expenses?

Bimal Giri: I think, if you are comparing Q4 versus Q1, I think SSKI's off-takes in Q4 was higher than expected because of the kind of revenues they saw there. I think if that is how you are comparing you will get the kind of trend you are speaking about.

Manish: And lastly, you have mentioned there was some mark to market charges on the bond side, do they reflect in the provisions number or do they reflect in the treasury part?

Rajiv Lall: They reflect in the provision.

Manish: Thanks, that's all.

Moderator: Now we hand over the floor to Mr. Rajiv Lall for closing comments.

Rajiv Lall: Thank you everybody for being with us this evening. We hope that we have answered most of your queries. If you have additional questions, please do not hesitate to contact our investor relations team. We will help you as best as we can and we look forward to talking to you again next quarter. Thank you.

Moderator: Ladies and gentlemen this concludes your conference for today. Thank you for your participation. You may disconnect your lines now. Thank you and have a pleasant evening.